Reshaping Corporate Asia

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ABSTRACT

In the aftermath of the Asian financial crisis of 1997-98, the Pacific Rim countries, especially the Southeast Asian economies, had to find ways of dealing with the effects of globalization. Especially in the financial sector, the international community was demanding the rule of law, international accounting standards, transparency, and a corporate structure that will permit investors and lenders better access to corporate decision-making. The research here is revisiting four countries – Korea, Singapore, Thailand, and China – to examine the progress of these economies in regard to corporate restructuring.

INTRODUCTION

It was the Asian financial crisis of 1997-98 that for the first time fully raised awareness of the increasing interdependence of national economies. It clearly showed the impact of globalization on all economies, whether they were western industrialized countries or emerging markets. Especially noticeable became the vulnerability of the Southeast Asian nations to the forces unleashed by global integration. These small economies did not have the necessary well-developed financial institutions to withstand the vagaries of the money flows in and out of investment opportunities in search of the best return.

For emerging markets to become integrated into the global economy would mean for these nations to develop the necessary institutions to keep up with the more developed economies, and in the financial sector to meet the demands of investors and lenders to cooperate with international rules. The rules of global integration go beyond the financial sector. There is the demand for the rule of law, for international accounting standards, for transparency, and a corporate structure that will permit investors and lenders to participate in corporate decision-making as price for public listing and access to the financial markets.

The financial crisis of 1997-98 exposed the weakness of the domestic political systems in Southeast Asia. These systems depended on traditional, personalized control and manipulation by powerful elite groups rather than on strong, independent institutions and legal systems (Parker, 1998). In reaction to the crisis the need for global rules became apparent and with it the demand for more transparency, standard accounting principles, contract law, better regulation, investor rights, and the strengthening of the financial sector. The call for such universal standards has influenced the Asian countries to adopt new business cultures and corporate structures and to abandon age-old ways of doing business.

At the onset of the financial crisis the most important issue was to stabilize the financial system and prevent a credit crunch. With the assistance of the International Monetary Fund and western countries, some of the affected Asian economies were able to contain the crisis in a relatively short time. However, containment is not sufficient. It takes further steps to avoid a recurrence by restructuring and strengthening financial institutions. The governments of Malaysia, Thailand, Indonesia, and South Korea have intervened in nonviable financial institutions and have started to take steps to improve regulation and supervision. Of these countries, South Korea has made the most progress in financial restructuring (Sharma, 2002).

Still there is much to be done. Inadequate regulation, weak supervision of financial institutions, poor accounting standards and disclosure rules, outmoded laws, and weak corporate governance continue to pose considerable problems (Sharma, 2002). Southeast Asian governments have pursued various approaches to corporate reorganization. One method used is mergers and acquisitions. The number of mergers and acquisitions has increased greatly, again with the largest increase in South Korea. Overall, however, the progress in corporate overhaul has been modest. For these countries to become competitive, corporate as well as debt restructuring has to be addressed aggressively (Sharma, 2002).

The Asian communities each have their own particular set of culture and value systems which contributed to a range of political governance models which supported different industrial approaches from those of the West (Wharton, 1999). Asia's tycoons were coming under increasing pressure to adopt a more western style of doing business. Gradually, Asia's companies have started to shift (*The Economist*, 2000). The patriarchal structure with the unquestioned authority by the tycoons went hand-in-hand with a strong influence of family. In business dealings the ethnic network was preferred. Capital was raised within the network, for instance from affiliated banks (*The Economist*, 2001). The financial crisis devastated the balance sheets of many Asian companies, as well as those of their banks. This meant that firms had to go outside the network to raise money. With stock market listings the companies had to accept more disclosure and greater influence by shareholders in the running of the business (*The Economist*, 2000).

It is interesting that the more developed a country, the lower the number of corporations controlled by a single family. In Japan, for instance, fewer than 10 percent of companies are controlled by a single family. The same percentage is present in European countries. In South Korea and Taiwan, just under 50 percent of companies were under family control. For Thailand and Malaysia the ratio tends to be 60-70 percent, and in Indonesia and the Philippines it is even higher (Claessens, et al, 1999). But as companies become listed on exchanges, the surveillance from the capital markets forces more visibility of ownership. The mature capital markets in western countries had time to put pressure on the practices of family businesses. In Southeast Asia capitalism has not had the time to check the power of the controlling shareholders and to protect the rights of minority investors. (*The Economist*, 2001).

The increasing pressures of the global economy now undermine the traditional practices and destroy the old business model and network, and allow for entry of new companies and competition (*The Economist*, 2000). For many companies this means reorganizing, forming alliances with western companies, and accepting western-style business methods.

The question arises, how much have Southeast Asian countries adjusted to the pressures of globalization and restructured their corporations and institutions? The aim here is to investigate these countries in regard to their reactions to globalization and observe how far they have come in adjusting to the new reality. Countries included in this review are Korea, Singapore, Thailand and China.

METHODOLOGY

The core of this research is based on over 110 interviews in Shanghai, Beijing, Hong Kong, and Singapore during the last five years, including 18 months in the Far East during the years 1999 and 2000. Also, some of the data stem from research first done in Tianjin and Beijing in 1988-89. In the last three years research was collected in Washington, D.C. on China and in Shanghai in the summer of 2003, in Hong Kong in summer of 2004, Washington, D.C. and China in the summer of 2005.

Because of the politically sensitive situation in the countries indicated, those interviewed requested anonymity and therefore, all information is kept confidential. In the years from 1997 to 2005, the interviews were conducted with senior officers and analysts in many corporations, government agencies, and private institutions in Shanghai, Beijing, Hong Kong, and Singapore. A partial list of interview sites, together with a list of sample interview questions, can be found in the Appendix.

SOUTH KOREA

South Korea can serve as example for a country that has made the transition from authoritarianism to democracy and from low-end, exporting economy to one that is increasingly high-tech (Bremmer and Moon, 2002). Many changes have followed the economic trauma of 1998. While much of Southeast Asia continues to struggle with a weak banking system and some areas are facing dwindling foreign investment, South Korea stepped up the pace of dealing with its problems. The government started to curb the worst excesses of the chaebol, which once absorbed much of the nation's capital (Balfour, 2002). Cutting the connection between banks and the chaebol was instrumental.

Using the IMF's demands for reform, the government of President Kim put pressure on the heads of the chaebol to reshape their empires. They were instructed to downsize, swap non-core businesses, sell off other parts, slash debt. President Kim enacted reforms that led to the breakup of Daewoo and Hyundai. The result was that of the 30 biggest chaebol, 16 have been either closed or considerably downsized. Those which survived, among them Samsung Group and LG, are today entirely different corporations than before (Bremmer and Moon, 2002).

The house cleaning included the banking sector. In 1998, some 2000 financial institutions were overloading the banking industry. There are only 1,600 left. Of 24 major city banks, only half remain. With the link to the chaebol removed, billions of capital became free for new loans. Now it became possible to make loans to consumers and small businesses. In retail banking, the surviving banks started to issue credit cards and mortgages to consumers which helped to strengthen the domestic consumer market. (*The Economist*, 2004, January 10). Furthermore, the administration opened the economy to foreign competition and investment. The outcome was that there is now a healthier balance between growth in the domestic market and the export sector, and an economy that showed a 4 percent gain in GDP in the past year.

Large strides have been made, but many problems remain. Labor unions threaten. Some of the still existing chaebol are basically worthless companies which are draining bank funds. Many of the small and mid-sized companies are not globally competitive. And political corruption with influence-buying scandals is still on the horizon (Bremmer, 2002). The new administration under newly-elected President Roh is continuing the fight against the chaebol. The case against the head of the SK Group could result in a further purge of chaebol practices. According to a shareholder activist group, People's Solidarity, which triggered the SK Group probe, the larger chaebol still cheat shareholders and try to manipulate the market. (*The Economist*, 2004, February 28). The future will tell whether or not President Roh has the will to change corporate governance and transform the markets. However, the perception is that corporate reforms are slowing.

SINGAPORE

Singapore represents a significantly different case of corporate governance and reform. Singapore has been a dramatic success as a city-state oriented to international business and commerce. In the age of high technology and the knowledge worker, Singapore's leadership seeks to expand its economic and business culture to take the island nation to new levels. As a 76 percent Sinic society, Singapore has had to contend with the classic Asian cultural tradition of the paternalistic family-dominated business firm. This has become a particularly acute problem as Singapore's leadership has sought to liberalize its systems to become more competitive internationally. The financial management reform is the best example of the Singapore effort.

Core Values

Underlying the success of Singapore is a dynamic value consensus stemming in great part from a society that is 76 percent Chinese and as such infused with Confucian values. These core values include a focus on social discipline, education, secular achievement and business and trade. One of the most important aspects of this cultural tradition is the extended overseas Chinese family and social network. The economist Joel Kotkin states that this network extends throughout Southeast Asia and the Pacific Rim. He argues that the Chinese ethnic and cultural network is primarily responsible for the productivity and management of the most successful business enterprises throughout East and Southeast Asia (1994). Singapore is clearly a key unit in this network.

It is not possible to tell the story of Singapore without the underlying leadership of Lee Kuan Yew. From the beginning he focused on an open door trading policy toward the West and Singapore's neighbors in Southeast Asia (on-site interviews). Lee's approach has been heavily authoritarian. Singapore is governed as a single-party dictatorship under the People's Action Party (PAP) led by Lee Kuan Yew. The PAP has permeated every aspect of

Singapore society. Lee stepped down as prime minister in November 1990 to occupy a new position that was created for him, that of Senior Minister. Lee remains the dominant political force in Singapore and he is currently planning and leading an effort to loosen the political rules, liberalize the economy, and change corporate governance (on-site interviews).

Multinational Strategy

In the late 1960s and early 1970s, Singapore's predominantly Chinese merchants favored continued free trade and most did not object to the large amounts of multinational capital which flowed into the city-state in the late 1960s and early 1970s. Most of the new investment was in 100 percent foreign-owned enterprises. By the late 1980s, through its open-door policy, Singapore probably had the most heavily foreign dominated manufacturing sector in the world, with wholly-owned foreign subsidiaries and major foreign-owned joint ventures accounting for over half of employment, two-thirds of output and value-added and over four fifths of direct exports (Murray and Perera, 1996).

The government also sought to make Singapore an international financial hub. The first foreign bank was admitted in 1971. Bank development for serving international business interests had certainly been a consistent evolution since Singapore's independence in 1965. Singapore has embarked on major restructuring of the banking sector accompanied by bank liberalization and reform to make the industry more competitive regionally and internationally.

Corporate Reform

Globalization requires economic liberalization and changes in corporate governance away from the traditional Asian family model. Globalization is the rapid integration of finance, cultures, trade, national policies, and business on the basis of free markets and information technology. Singapore's leadership knows that it has to continuously evolve in order to further sustainable competitive advantage.

At a conference in Singapore on November 19, 1999 Southeast Asian business leaders and managers perceived Singapore and Hong Kong as the most important entities from an international financial business perspective. But the participants also pointed to some significant weaknesses which Singapore is facing. Cost and availability of skilled management employees pose a definite challenge for multinational companies. Regional and country regulators fail to give clear directions to banks, companies, and other service providers regarding the type of services permitted. Incentives to attract site operations in Singapore have also been lacking. Implied is that Singapore must hire internationally and reform corporate structure (Economist Conference, Singapore, November 19, 1999).

Bank Reform

Although regionally successful, Singapore's political and business leadership has been acutely aware of global banking restructuring in terms of merger, acquisitions and cost cutting. Thus, in June 1999, Singapore's Monetary Authority (The Central Bank) initiated reforms to open Singapore's family-owned and protected banking sector to pressure banks to be more competitive regionally and internationally. The hope is that by allowing the entry of international banks, the local banks will engage in the necessary merger, acquisition, international marketing, and changes in traditional management (Interview with Lee Hsien Loong, 1999).

Lee Hsien Loong, currently head of the Monetary Authority, addressed the issue of bank reform. He states, "In the middle of 1997 we decided that we would embark on a major review and a change in course….it was an opportunity for us to get ahead at a time when many countries would be busy with the crisis. Of course we had to deal with the crisis, too, but our banking system was sound. And so we have the room to make adjustments and to continue to open up, even though the outlook was not overwhelmingly optimistic. We've been doing it progressively over the last two years (Interview with Lee Hsien Loong, 1999)."

With its support of multinationals for example, Singapore's development of its information technology system has been according to government plan from the beginning. This may have led to rigidities, but it has also led to an advanced wired society with great opportunities for change. Henry Nicholas, chairman and CEO of Broadcom, Corp., producer of high-powered chips that tie together the worlds of internet and television, states that "The government coming in making everything painless and seamless is critical." He further explains that the technology is there to hold interactive teleconferences with colleagues in the U.S., in which they can share data and work off the same models simultaneously. Singapore's telecommunication infrastructure will allow him to do that 24 hours a day, seven days a week. (*The Asian Wall Street Journal*, October 4, 1999).

The official government policy of promoting partnerships converges and reinforces the proactive open-door policy toward multinational corporations. The idea of partnership is the concept that companies from countries such as America, Britain, France, Germany and Japan should team up with Singapore counterparts, whether government-led or from the private sector, to invest and carry out business in areas like China, India, and Vietnam. According to one observer there are many foreign companies who are happy with Singapore's multinational strategy. They are at ease here. The people speak English: the Chinese are westernized; it's a user-friendly country; the legal system is good and it is a transparent economy.

THAILAND

After two examples of embracing globalization and modernization, Thailand will show a local, internal approach to dealing with outside pressures. Thailand's response might be described as a Thai form of "populism." But it clearly does not include an emphasis on corporate governance reform (Scott, 1999). First, it is important to understand how well Thailand is currently doing under its new leadership. In Asia, Thailand is currently second only to China in the success of its economic advancement. Whether this is sustainable remains to be seen (on-site interviews). Gross domestic product growth has reached 6-7 percent in the 2003-2005 period, exports are up almost 20 percent, and the property market is experiencing strong growth. (on-site interview). Additionally, Thailand has achieved a current-account surplus averaging some $600 million per month (*Asian Wall StreetJournal*, August 7, 2003), and the baht has appreciated against the dollar. In order to manage foreign inflows, the Bank of Thailand has put restrictions on the amount foreigners can hold in baht accounts. (*The Economist*, 2003).

Thailand's policy orientation is unique. Thailand's new leadership wants a so-called "dual track" economic development strategy. First, this means moving Thailand away from the traditional model of dependence on exports and foreign investment. The traditional approach would also require privatization, rule of law (including bankruptcy law), floating currency, lower trade barriers, and corporate reform. These pro-market initiatives are currently not on top of the list. Instead, the Prime Minister Thaksin Shinawatia wants a government-guided pro-business orientation for small and medium-sized enterprises at the village level. The idea is to create local links with globalization that will allow Thailand to market differentiated local goods and move up the value chain. This would give Thailand pricing power. The vehicle of the "one Tambon (sub-district), one product" scheme is one strategy. This is a niche strategy. It is also a rejection of the passive policy of accepting Foreign Direct Investment (FDI) for mass-produced goods. The problem is that this path will only reinforce traditional Asian paternalistic cultural values in business and management since it emanates directly from the village level. Moreover, there is no evidence that any of this is accompanied by skills training. In fact the evidence is that the Thai government continues to cut spending on education rather dramatically (on-site interviews).

The popularity of the current government may be a consequence of the populist expansionist policy. Bilateral and preferential trade agreements with a variety of partners is part of this growth strategy. However, fiscal discipline remains as a major problem. It also seems that the reforms have never really been completed. This can be seen in the cluster of old problems: lack of substantial bank reform, political loans, too close a relationship between government and business, lack of transparency, and a measure of corruption.

CHINA

China is experiencing a three-fold transition. In economics, China is moving from central planning to the market. In politics, China is moving from the arbitrary rule of men to the rule of law. In social terms, the society is moving from a closed to an open society.

The reformers have been in control in China since 1978 and view the World Trade Organization (WTO) as another lever of reform for corporate governance particularly in regard to banks and state-owned enterprises. But the surface is deceptive and there are strong interests in opposition. The risks for business in this market are huge especially as a result of the lack of effective legal guidelines. The environment for smaller firms is particularly problematic.

The depolitization of commercial decision-making is at the core of corporate governance reform. China's accession to the WTO is based on the rule of law and market-based institutions. Politics should not direct commercial decision-making. State-owned enterprises still play a large role in the economy. However, China claims that purchases and sales will be based on commercial considerations (on-site interviews). China has also committed itself to providing U.S. and other foreign firms the opportunity to compete for sales and purchases under non-discriminatory terms and conditions. Business license decisions should be based on objective and commercial criteria, not political considerations. Corporate governance needs to be transparent and accountable (on-site interviews).

China's economy is growing strongly with current growth at about 8 percent. It should be mentioned that 8 percent is an "official" figure and official figures are suspect. Nevertheless, the growth averages out to almost 5 percent over 23 years and double digit expansion at times, particularly in certain areas like the Pearl River Delta (on-site interview). China is privatizing. Exports are strong. The half-protected currency is stable. High technology and information technology are expanding. Consumer purchases are rising and interest rates are falling. Foreign direct investment is increasing as China becomes the investment target of choice in Asia. Market potential – size and profitability – remains the major reason that U.S. companies sometimes enter with preemptive strategy and to serve other China-based multinationals (on-site interviews).

Trade and FDI frequently drive development in transition economies. China's stunning growth is related to these variables. FDI has easily been the highest in Asia. Some of the reasons for this included the following: WTO accession and the rule of law; cheap labor; global positioning; large internal market; government pro-growth policy and privatization; rapidly growing widespread internal wealth and discretionary income; consensus on reforms (on-site interviews). Finally, it is important to mention the current direction of the consensus on market reforms. In a presentation in Singapore on November 30, 1999, Zhu Rongji, Premier of State Council, articulated his view on China's economic achievements and obstacles. He stressed that China's economic success must be seen as a consequence of reform efforts. Moreover, the premier focused on the assumption that the only way to modernize China is through opening to the outside world and continued reform. He emphasized that three strategies have been adopted: 1. Expand domestic demand with fiscal and monetary policies. 2. Continued readjustment of economic structure by opening up the economy for long-term foreign investment and enhancing the role of private enterprise. 3. Development of Western China (on-site interviews).

China and the WTO

Arrayed against the forces of tradition in China, one finds the prodigious forces of globalization in part represented by the WTO. After 15 years, China acceded to the WTO in November of 2001. The WTO is an agent of globalization creating change and political risk. But it also provides a bridge across the turbulence. The reformers' drive to move forward into the WTO is itself a central symbol of China's continued modernization. Three areas of change are particularly addressed WTO accession: 1. The rule of law, 2. bank reform, 3. market access reform.

The Rule of Law and Corporate Governance

Perhaps the most important impact of the WTO will be the rule of law and administrative procedures. One of the principle efforts will be to enforce greater transparency. The rule of law and transparency are the essential infrastructure of economic and social development. China's accession to the WTO requires that China make available the laws and regulations concerning trade and investment before they are implemented or enforced. Prior notice and opportunity to comment on proposed laws and regulations would greatly enhance efficiency and allow the government to institute its laws and regulations with a more complete understanding of their implications, particularly as they apply to business (on-site interviews).

Bank Reform and Corporate Governance

Bank liberalization will be a key reform in the entire program. Under the "old system" the role of banks was to serve as conduits for channeling money from the government into state enterprises. The majority of these enterprises are now bankrupt and need recapitalization (on-site interviews). The WTO impact on banking will be profound: 1. Foreign banks will be allowed to conduct local currency transactions with Chinese enterprises starting two years after accession and Chinese individuals 5 years after accession. 2. There will be a complete lifting of geographic and customer restrictions for foreign banks that will be phased in over 5 years. 3. U.S. banks will have full access in five years (on-site interviews).

In the face of these progressive goals articulated by the reformers, there are strong countercurrents that affect corporate governance. The state-owned banks remain a major part of the financial management problem. (*The Economist*, 2004, January 10). The issues are threefold. First, there is no match between loans and assets. Second, there are too many political loans. Third, there has been historically no monitoring (on-site interviews). WTO membership has increased the activities of foreign banks in China. Several U.S. and British banks have enlarged the holdings in the bigger Chinese banks. But progress is still slow. Government hopes that outside investors will pressure the banks to clean up their act. (Geib and Pfaff, 2005).

In his recent book, *The China Dream*, Studwell argues that the China market is a quagmire for capitalists. He suggests that the reforms since 1978 have been more promise than reality. He believes that the reformers have essentially failed by refusing to restructure the state-owned enterprises and reform banks (2002). China scholar Nicholas Lardy underlines in his study that while China reforms slowly, they are indeed advancing. Like Studwell, Lardy sees China's financial system as its Achilles heel, but he believes that increased FDI and the need to export will bring reforms (2002).

Corruption is Endemic

The corruption of political loans remains a major issue for financing the system for large firms and small. According to recent press reports on both sides of the Pacific, "tawdry" details of questionable banking practices have been accumulating. An example of corruption at the highest levels is the forced resignation of Wang Xuebing, President of the China Construction Bank (CCB). These concerns have reached the highest levels with the unfolding problems at China's most important state bank, the Bank of China (BOC). In January 2002, first came a report from China's National Audit Office which found at $320 million in bank funds had been diverted from several branches of the bank through "unlawful loans, off-the-books business and the unlawful granting of letters of credit and issuing bank bills." Also, American bank regulators have indicated that an investigation begun in 1999 had turned up the same kinds of irregularities at Bank of China's U.W. operations. The bank was fined $20 million in the case (*New York Times*, February 1, 2002).

CONCLUSION

The examination of the four countries discussed reveals that each country is approaching the pressure of globalization in its own unique way. Tradition and culture, as well as political and economic systems, play a vital role in the choice of policies and the vigorous or slow approach to implementation. Singapore was always in the forefront of modernization in the region and continuously pushes corporate restructuring and reforms to meet global standards. The case of Korea demonstrates that the political leadership has recognized the necessity of incorporating its economy in the greater global economy and it is taking the steps to achieve this goal by implementing corporate reorganization to meet global standards. Thailand on the other hand is seeking to nurture local impulses and slow down the impact of globalization. In the long run this may prove detrimental for Thailand.

China is the emerging giant. As a transition economy, it is in the middle of the transformation into a market economy, while at the same time trying to hold on politically to a totalitarian regime. Although the leadership seems to be committed to modernization and a market economy, the undercurrents are still trying to slow the process and hold on to local political control. As Studwell has argued, China remains a treacherous business environment.

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APPENDIX

A. Interviews:

Interviews were conducted at the following sites, among others: U.S. Commercial Service Shanghai, U.S. Agricultural Trade Office Shanghai, The American Chamber of Commerce Shanghai, U.S. Embassy Beijing, Hong Kong Monetary Authority, Hong Kong Development Authority.

Business sites included: Microsoft Asia (Singapore), Blake, Dawson, Waldron (law), The Boston Consulting Group, AIG Investment Corp., Financial Times, Anheuser-Busch, Honeywell Corp., Bear-Stearns Hong Kong, Merrill-Lynch Hong Kong, Goldman-Sachs.

B. Sample questions of the interviews:

1. What is your assessment of the macro-economic changes that have been underway for ten years?
2. What is your assessment of the impact of the Asian Financial Crisis on the strategic management of U.S. Firms? Particular focus will be on the reform of financial institutions.
3. What is your view of the principal strategic management opportunities and problems for U.S firms within the framework of the financial crisis given the problems of monetary, fiscal, and currency exchange instability?
4. What is your view of the organizational and corporate culture changes that have to be made for the firm to effectively function after the financial crisis?
5. What is your view of the banking system and the specific threats and opportunities stemming from it in light of the financial crisis?
6. What is your view of the banking system and the threats and opportunities stemming from it in view of the context?
7. What is your view of the status of intellectual property and the protection provided for it by Asia's evolving legal system?
8. What is your perception of the threats and opportunities to your business presented by the evolving legal framework given the problems of corruption and lack of transparency?
9. What are your criteria for the development of an effective joint venture? Most importantly what criteria do you use for the selection of a partner?

NOTES